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AGENDA ITEM 3b

TO: MEMBERS OF THE PERFORMANCE AND COMPENSATION COMMITTEE

- I. SUBJECT:** Investment Incentive Compensation Program Redesign
- II. PROGRAM:** Administration
- III. RECOMMENDATIONS:** Approve Revisions to the Program Policy as Presented in Attachment 1
- IV. ANALYSIS:**

Background

At the June meeting of the Performance and Compensation Committee, considerable discussion was held regarding the retention of our most highly skilled Investment Managers during these turbulent times in both the public and private financial sectors. At the direction of the Committee, staff was asked to prepare a proposal to address employee retention.

Existing Compensation Policies and Procedures offer limited options and little flexibility to retain key investment staff. The purpose of this agenda item is to propose a revision to the Compensation Policies and Procedures to address the retention of key Investment Managers who may be at risk of leaving CalPERS due to the long-term impact of the total fund return on performance awards and total compensation. Investment Managers include the Chief Investment Officer, Chief Operating Investment Officer, Senior Investment Officers, Senior Portfolio Managers, and Portfolio Managers.

CalPERS is emerging from one of the most challenging investment periods in its long history. One of the keys to the recent rebound of the fund is our outstanding staff and their diligent efforts during the last year and a half. In both good economic times and bad, recognizing and retaining talented staff is always a priority. As the financial markets continue to improve, so potentially will outside employment opportunities for talented, experienced staff. The cost of replacing our most highly skilled managers or using external investment consultants would be far more costly than creating a mechanism to retain staff. Rather than

respond reactively to staff turnover, this agenda item proposes a proactive approach to insure key investment managers remain with CalPERS during this critical time.

Current Policy

In addition to base salary increases that may be awarded in conjunction with the annual performance review process, the current policy contains a provision under the *Additional Special Pay and Appointment Considerations* section that permits the Chief Investment Officer (CIO) to provide within range salary adjustments of up to 15% at any time of the year to address retention or internal equity issues. In extenuating circumstances, with the approval of the Chief Executive Officer (CEO), the pay increase may exceed 15%. All such special adjustments granted under this provision are reported to the Performance and Compensation Committee and the Board in closed session.

Although existing policy would appear to address most retention situations that may arise, there may be scenarios where a within range adjustment is not possible or desirable. For example, if a highly valued Investment Manager is at the top of the salary range, there are currently no viable options in place to retain the manager other than a promotion. Depending on the circumstances, a promotion may not be feasible. Furthermore, a base pay increase, which results in a permanent adjustment to an employee's salary, may be a less desirable and suitable approach to retention than a one-time retention award.

Proposed Policy Revision

Attachment I presents, in underlined format, a proposed revision to the *Additional Special Pay and Appointment Considerations* section of the Compensation Policies and Procedures. This proposed revision would provide an additional option to aid in the retention of talented employees who are deemed critical to the successful management of the fund.

V. STRATEGIC PLAN:

Under Goal III of the Strategic Plan, CalPERS is committed to sustaining a high performance work culture. This can be accomplished at the highest executive levels through the establishment of methods that provide broad flexibility in the recruitment, retention and compensation of key personnel.

VI. RESULTS/COSTS:

The establishment of performance plan measures is critical to the management of a competitive compensation program for executives at the highest levels of the organization. This, in turn, is critical to the success of the organization. The cost of performance awards that might arise from the recommendations in this item will be funded from existing resources.

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Attachment